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IN THE

Supreme Court of the United States

RICHARD GERALD ROUSEY and BETTY JO ROUSEY,

Petitioners,

v.

JILL R. JACOWAY.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONERS

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QUESTION PRESENTED

Whether and to what extent Individual Retirement Accounts (IRAs) are exempt from a bankruptcy estate under 11 U.S.C. 522(d)(10)(E).

PARTIES TO THE PROCEEDINGS BELOW

The only parties to this proceeding are named in the caption.

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BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit (Pet. App. 1a-6a) is published at 347 F.3d 689. The Eighth Circuit's order denying the petition for rehearing and rehearing en banc by a vote of five to four (Pet. App. 36a) is unpublished. The opinion of the Bankruptcy Appellate Panel for the Eighth Circuit (Pet. App. 7a-18a) is published at 283 B.R. 265. The opinion for the Bankruptcy Court for the Western District of Arkansas (Pet. App. 19a-35a) is published at 275 B.R. 307.

JURISDICTION

The judgment of the court of appeals was entered on October 20, 2003. A timely petition for rehearing and rehearing en banc was denied on January 9, 2004. This Court has jurisdiction pursuant to 28 U.S.C. 1254(1).

RELEVANT STATUTORY PROVISIONS

11 U.S.C. 522 provides, in relevant part:

(d) The following property may be exempted under subsection (b)(1) of this section:

*****

(10) the debtor's right to receive—

*****

(E) a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless –

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the

debtor's rights under such plan or contract arose;

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code of 1986.

STATEMENT

The question presented by this case is whether and to what extent payments from an Individual Retirement Account (IRA) constitute "exempt property" under 11 U.S.C. 522(d)(10)(E). Acknowledging that its reading of the statute had been rejected by four other courts of appeals, the Eighth Circuit in this case held that IRAs do not qualify for exemption.

1. After twenty-six years of employment with Northrop Grumman Corp., petitioner Richard Gerald Rousey was forced into early retirement in December 1998. His wife, petitioner Betty Jo Rousey, who had been employed with Northrop Grumman for eight-and-a-half years, was laid off the following January.

Due to the termination of their employment, petitioners were required to transfer the funds they had accumulated in their Northrop Grumman retirement plans. They "rolled over" their funds into IRAs that each established at the First National Bank of Berryville (Bank).[1] The IRAs were funded entirely by the proceeds of Mr. Rousey's pension and Mrs. Rousey's 401(k) plan, respectively, and "qualif[ied] for tax-exempt status under § 408" of the Internal Revenue Code. Pet. App. 26a.

[1] Petitioner Richard Rousey established his IRA by a direct rollover of the $38,574.44 from his qualified plan on March 23, 1999; petitioner Betty Jo Rousey established her IRA by a direct rollover of the $11,193.36 from her 401(k) plan on April 26, 1999.

2. Subsequently, petitioners jointly filed a voluntary Chapter 7 petition in the United States Bankruptcy Court for the Western District of Arkansas. When a debtor files a bankruptcy petition, most of the debtor's property becomes part of the bankruptcy estate, which a bankruptcy trustee will convert into cash and distribute to the debtor's creditors. See 11 U.S.C. 541; *Taylor* v. *Freeland & Kronz*, 503 U.S. 638, 642 (1992). However, a debtor may seek to retain some of his property by claiming an exemption pursuant to 11 U.S.C. 522. See *Taylor*, 503 U.S. at 642. These exemptions "permit an individual debtor to take out of the [bankruptcy] estate that property that is necessary for a fresh start and for the support of himself and his dependents." H.R. Rep. No. 95-595, at 176 (1977). Pursuant to Section 522(b) of the Bankruptcy Code, petitioners elected to receive the federal exemptions provided for in 11 U.S.C. 522(b)(1), which incorporates the exemptions listed in Section 522(d).[2]

The provision of the Bankruptcy Code at issue in this case, Section 522(d)(10)(E), permits a debtor to exempt "the debtor's right to receive * * * a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract." 11 U.S.C. 522(d)(10)(E). An exemption is allowed only to the extent that the funds are "reasonably necessary for the support of the debtor." *Ibid.*

Pursuant to Section 522(d)(10)(E), petitioners claimed an exemption of $44,352.48 for funds in their IRAs. The trustee objected on the ground that IRAs were not a "similar plan or

[2] The trustee did not object to petitioners' exemption of $10,681 of the value of petitioners' IRAs pursuant to 11 U.S.C. 522(d)(5). Section 522(d)(5), the so-called "wild card" exemption, provides in pertinent part that a debtor can exempt from the bankruptcy estate his "aggregate interest in any property, not to exceed in value $975 plus up to $9,250 [at the time of petitioners' Chapter 7 filing, the amounts were $925 and $8,725] of any unused amount of the exemption provided" elsewhere in the subsection for the debtor's residence or a burial plot (see 11 U.S.C. 522(d)(1)).

contract" within the meaning of Section 522(d)(10)(E). The bankruptcy court agreed, relying on the fact that the holders of IRAs may withdraw funds (albeit subject to a ten-percent tax penalty, see 26 U.S.C. 72(t)(1)) before they reach the age (59½) at which IRA holders are eligible for non-penalized payments under federal law. Pet. App. 34a. According to the bankruptcy court, the ability to make tax-penalized withdrawals from an IRA means that payments are not made "on account of illness, disability, death, age, or length of service" as required by Section 522(d)(10)(E). Pet. App. 34a-35a.

The bankruptcy appellate panel affirmed. Pet. App. 17a. However, a concurring opinion invited the Eighth Circuit to revisit its prior precedent relating to "this issue where, as here, the debtors' pensions would have been exempt had they filed their bankruptcy petition while employed by Northrop Grumman, but they are not exempt where the debtors filed after their employment ceased and they rolled over the proceeds of their Northrop Grumman pensions into IRAs." *Id.* 18a.

3. The Eighth Circuit in turn affirmed, though only on one of the two grounds invoked by the lower courts. Pet. App. 6a. The court of appeals essentially agreed with *petitioners* that an IRA is a "similar plan or contract" within the meaning of Section 522(d)(10)(E). Pet. App. 5a. The Eighth Circuit recognized that, like a pension, the funds in petitioners' IRAs were "established over time as part of a long-term retirement strategy" and "serve[d] as a substitute for future earnings." *Id.* The court of appeals noted that four other circuits had found IRAs to satisfy the "similar plan or contract" test, and that "dicta from the Supreme Court's opinion in *Patterson* [v. *Shumate*, 504 U.S. 753 (1992)] support this conclusion." Pet. App. 5a; see also *id.* 4a (citing *Dettmann* v. *Brucher (In re Brucher)*, 243 F.3d 242 (CA6 2001); *Farrar* v. *McKown*, 203 F.3d 1188 (CA9 2000); *Dubroff* v. *First Nat'l Bank of Glens Falls (In re Dubroff)*, 119 F.3d 75 (CA2 1997); *Carmichael* v. *Osherow (In re Carmichael)*, 100 F.3d 375 (CA5 1996)).

But based on prior Eighth Circuit precedent construing a state exemption statute, the court of appeals held that IRAs were nonetheless not exempt, unless the particular IRA in question categorically forbids early withdrawals. (The court of appeals was unable to identify any such IRAs.) Under that circuit precedent, IRAs do not meet the requirement that any payments be made "on account of * * * age." 11 U.S.C. 522(d)(10)(E). "[F]uture payments from the corpus [principal] of an Individual Retirement Annuity are not 'on account of age' where debtors have unfettered discretion to withdraw from the corpus at any time subject only to modest early withdrawal tax penalties." Pet. App. 6a (quoting *Huebner* v. *Farmers State Bank*, 986 F.2d 1222, 1225 (CA8), cert. denied, 510 U.S. 900 (1993)). The court of appeals acknowledged "that four of our sister circuits have reached a contrary result that may be more consistent with the purposes of § 522," but nevertheless deemed itself "constrained" by circuit precedent to reject that view. Pet. App. 6a.

4. Petitioners' motion for rehearing en banc was denied by a vote of five to four. A petition for a writ of certiorari was filed on April 6, 2004, and granted by this Court on June 7, 2004.

SUMMARY OF THE ARGUMENT

Individual Retirement Accounts (IRAs) are exempt property under Section 522(d)(10)(E). This Court specifically reached that conclusion in *Patterson* v. *Shumate*, 504 U.S. 753, 762-63 (1992), contrasting the scope of Section 522(d)(10)(E) and its application to IRAs with the narrower exemption applicable to plans that contain anti-alienation provisions. The Eighth Circuit's contrary holding denying petitioners' exemption for their IRAs lacks merit.

The court of appeals acknowledged that Congress intended Section 522(d)(10)(E) to encompass at least some IRAs. But it concluded that the statute exempts only those plans or contracts, including IRAs, that categorically forbid early withdrawals. That cannot be right. So far as can be de-

termined, there simply are no IRAs that include such a prohibition, for the Internal Revenue Code authorizes early withdrawals from qualified plans, subject to a tax penalty. Moreover, many plans and contracts that are expressly exempt under Section 522(d)(10)(E) permit early withdrawals. For example, pre-retirement withdrawals from 401(k) pension plans upon the termination of employment are common. The Eighth Circuit's decision therefore implausibly excludes from exemption many of the plans that Congress expressly included.

The judgment below thus can be sustained only if an IRA is not a "similar plan or contract" for purposes of Section 522(d)(10)(E). But even the court of appeals recognized that such a conclusion cannot be supported. The statutory text is dispositive. It expressly refers to the Internal Revenue Code provision governing IRAs.

Further, IRAs are indisputably "similar" to the plans and contracts that Congress expressly identified in Section 522(d)(10)(E). IRAs, like those devices, permit withdrawals without tax penalties on the grounds listed in the statute: on account of illness; if the account holder is disabled; on or after the account holder's death; or on or after the date on which the IRA holder reaches age 59½. 26 U.S.C. 72(t)(2). Contributions to IRAs and the qualified retirement plans listed in Section 522(d)(10)(E) are also tax deductible and subject to annual limits.

Only petitioners' construction can be reconciled with the purpose of Section 522(d)(10)(E). Consistent with the "fresh start" principle of federal bankruptcy law, the statute exempts plans that provide replacement income during retirement, reflecting the congressional recognition that older debtors are unlikely to have the opportunity to re-accumulate significant assets after bankruptcy. IRAs are a vital form of retirement savings, indistinguishable in that respect from traditional pensions. For example, there is no dispute that petitioners' pensions would have been exempt had they continued to work at

Northrop Grumman. Congress could not logically have intended to exempt those pensions while denying exemption to the same assets when they have merely been rolled over into IRAs.

The history of federal bankruptcy law bears out petitioners' reading of the statute. The earliest bankruptcy statutes exempted assets necessary for the debtor's future support. Over the past two centuries, Congress has consistently expanded that exemption. The statutory history belies any suggestion that the particular form in which retirement assets are held is determinative of whether the exemption applies.

Finally, there is no merit to the Third Circuit's novel rule – which the Eighth Circuit did not embrace – that the exemption of Section 522(d)(10)(E) is available only those debtors who are at least 59½ years old when they file for bankruptcy and thus can withdraw funds without penalty. The Third Circuit rested its conclusion not on the statute itself, but on a single excerpt of the legislative history that was taken out of context. The statutory text applies to the "right to receive" payments, terminology that equally encompasses future payments – *i.e.*, payments to individuals who lack a present right to receive non-penalized distributions.

That is not to say that the debtor's age is irrelevant to the exemption conferred by Section 522(d)(10)(E). The statute exempts funds only "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." The lower courts have correctly limited younger debtors' ability to invoke the exemption, recognizing that those debtors have a greater prospect of building up retirement savings after emerging from bankruptcy. But petitioners have reached retirement age, and the Eighth Circuit in this case did not doubt that their IRAs are necessary to their support. The judgment below should accordingly be reversed.

ARGUMENT

Section 522 of the Bankruptcy Code governs the exemption of property from a debtor's estate in bankruptcy. Subsection (d) governs debtors who use the exemptions provided by federal law. In particular, Subsection 522(d)(10) exempts an array of income streams, such as Social Security payments, alimony payments, and unemployment benefits.[3] The provision at issue in this case, Section 522(d)(10)(E), exempts various forms of retirement and disability savings from the debtor's estate. The statute exempts "the debtor's right to receive * * * a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." 11 U.S.C. 522(d)(10)(E).

As the Eighth Circuit recognized, see Pet. App. 5a, this Court in *Patterson* v. *Shumate*, 504 U.S. 753 (1992), stated that IRAs qualify for exemption under Section 522(d)(10)(E). The debtor in *Patterson* participated in an employer-sponsored pension plan that contained an anti-alienation provision. This Court held that the plan was excluded from the property of the estate under Section 541(c)(2) of the Bankruptcy Code, which provides that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." 504 U.S. at 757.

In reaching that conclusion, the Court in *Patterson* specifically contrasted the exclusion provided by Section

[3] States may provide their own exemptions that supplement or replace the federal provisions. See 14 COLLIER ON BANKRUPTCY ¶ 522.01 (15th ed. 2004). In states (including Arkansas) that choose not to "opt out," debtors are permitted to choose between the federal exemptions in Section 522(d) or those available under applicable state and non-bankruptcy federal law. See *ibid.* Petitioners elected to proceed under the federal exemptions. See Pet. App. 8a.

541(c)(2)'s anti-alienation rule with the exemption available under the provision at issue in this case, Section 522(d)(10)(E). Few retirement planning devices qualify under Section 541(c)(2). By contrast, this Court explained, far more plans – including IRAs – satisfy the provision at issue in this case, Section 522(d)(10)(E). Thus, although "pension plans that qualify for preferential tax treatment under 26 U.S.C. § 408 (*individual retirement accounts*) are specifically excepted from ERISA's antialienation requirement," a debtor's interest in his IRA "*nevertheless could be exempted under § 522(d)(10)(E).*" *Patterson*, 504 U.S. at 762-63 (emphasis added).

For the reasons that follow, this Court's unanimous recognition in *Patterson* that IRAs are exempt under Section 522(d)(10)(E) was correct.

I. THE EIGHTH CIRCUIT ERRED IN CONCLUDING THAT THE SECTION 522(D)(10)(E) EXEMPTIONS ARE LIMITED TO PLANS AND CONTRACTS THAT PROHIBIT EARLY WITHDRAWALS.

Notwithstanding this Court's decision in *Patterson*, the Eighth Circuit in this case held as a matter of law that IRAs do not qualify for exemption under Section 522(d)(10)(E). The court of appeals essentially agreed with *petitioners* that IRAs are indistinguishable from the retirement savings devices named in the statute: "We agree that where an individual retirement account serves as a substitute for future earnings, Congress would probably consider it a 'similar plan or contract' as those explicitly listed in § 522(d)(10)(E)." Pet. App. 5a.

But the Eighth Circuit nonetheless held that IRAs are not exempt property. Ostensibly, the court's holding was that the statutory exemption applies to some – but not all – IRAs: those that categorically prohibit early withdrawals. "[W]here debtors have unfettered discretion to withdraw from the corpus at any time subject only to modest early withdrawal tax

penalties," the court concluded, payments from an IRA "are not 'on account of age.'" See Pet. App. 6a. Although (as a judge on the Bankruptcy Appellate Panel noted) petitioners' "pensions would have been exempt had they filed their bankruptcy petition while employed by Northrop Grumman," see Pet. App. 18a, and although nothing in the language of the statute limits exemption to plans for which payments are made "only" on account of age, the Eighth Circuit denied exemption to petitioners' IRAs.

The Eighth Circuit was correct in its conclusion that an IRA is a "similar plan or contract" under the statute (see *infra* Parts II & III), but it seriously erred in its conclusion that the exemption is restricted to a subset of IRAs that prohibit early withdrawals. The subcategory of IRAs that the court of appeals reasoned would qualify for the statutory exemption simply does not exist. Neither the court of appeals, nor petitioners, nor respondent have identified *any* IRAs under which early withdrawals are prohibited. That is not surprising, for federal law expressly contemplates that the holders of IRAs will be entitled – subject to a substantial tax penalty – to make such withdrawals. See 26 U.S.C. 72(t)(1) ("If any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c) [which includes IRAs]), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income."); see also *id.* § 72(t)(2)(A)(i) (excepting from penalty "[d]istributions which are * * * made on or after the date on which the employee attains age 59½"). Thus, the implausible consequence of the Eighth Circuit's holding is that, although Congress indisputably intended some IRAs to qualify for exemption under Section 522(d)(10), none actually do.

Moreover, the ability to withdraw retirement funds early – subject to a tax penalty – is common to *many* of the retirement and disability savings plans listed in Section 522(d)(10)(E). The prospect of early withdrawals thus cannot

be a feature that renders payments "not on account of age" and, as a consequence, precludes the applicability of Section 552(d)(10)(E). The same provision of the Internal Revenue Code (Section 72(t)) that addresses early withdrawals from IRAs thus applies equally to all "qualified retirement plans," 26 U.S.C. 72(t) – namely, those listed in Section 522(d)(10)(E): "(1) a plan described in section 401(a) * * *, (2) an annuity plan described in section 403(a), (3) an annuity contract described in section 403(b), (4) an individual retirement account described in section 408(a), or (5) an individual retirement annuity described in section 408(b)." 26 U.S.C. 4974(c). See generally Internal Revenue Serv., Publication 575, *at* http://www.irs.gov/publications/p575/ar02.html#d0e3742.[4] Early withdrawals from 401(k) pension plans, in particular, are common when participants change employers. See Amy B. Monahan, *Addressing the Problem of Impatients, Impulsives, and Other Imperfect Actors in 401(k) Plans*, 23 VA. TAX REV. 471, 500 & n.116 (2004) (discusing a study showing that "nearly half of workers who had a pension plan on a previous job report taking a lump-sum distribution before retirement age"). Indeed, the Eighth Circuit's analysis produces the absurd result that many of the plans Congress expressly specified were eligible for exemption under Section 522(d)(10) would not in fact be eligible.

The judgment below therefore can be sustained only if an IRA is not a "similar plan or contract" under Section 522(d)(10)(E). The Eighth Circuit itself notably did not believe that argument had merit. Indeed, the federal courts *overwhelmingly* conclude that an IRA constitutes a "similar

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[4] Early distributions from 401(k) pension plans, IRAs, and other qualified retirement plans may be permitted without tax penalty in a limited set of circumstances. See Internal Revenue Serv., Tax Topic 558, *at* http://www.irs.gov/taxtopics/tc558.html.

plan or contract."[5] For the reasons that follow, that consensus of authority is correct.

[5] See *Dettmann* v. *Brucher (In re Brucher)*, 243 F.3d 242, 242 (CA6 2001) ("The sole question presented in this appeal is whether an Individual Retirement Account (IRA) can be excluded from a bankruptcy estate * * * pursuant to 11 U.S.C. § 522(d)(10)(E). Following the reasoning of three other courts of appeals, we answer the question 'yes.'"); *Farrar* v. *McKown (In re McKown)*, 203 F.3d 1188, 1190 (CA9 2000) ("We thus hold, like our sister circuits, that an IRA qualifies from exemption under statutory language tracking 11 U.S.C. § 522(d)(10)(E)."); *Dubroff* v. *First Nat'l Bank of Glens Falls (In re Dubroff)*, 119 F.3d 75, 78-80 (CA2 1997) (holding IRAs exempt under a New York state statute "similar in all respects material to our inquiry" to Section 522(d)(10)(E)); *Carmichael* v. *Osherow (In re Carmichael)*, 100 F.3d 375, 376 & n.1 (CA5 1996) (concluding that "IRAs are exempt under [section] 522(d)(10)(E)]" with the possible exception of some unspecified "specially tailored IRAs"); *Velis* v. *Kardanis (In re Velis)*, 949 F.2d 78, 83 (CA3 1991) (denying exemption to debtor's IRA because "debtor had not shown the requisite need").

To the best of petitioners' knowledge, every bankruptcy court in the remaining circuits that has addressed the question whether IRAs can be exempt as "similar plan[s] or contract[s]" under Section 522(d)(10)(E) or a similar state exemption has concluded that they can. In the First Circuit, see, for example, *In re Marsella*, 188 B.R. 731, 732 (Bankr. D.R.I. 1995) (IRAs can be exempt under Section 522(d)(10)(E)); *In re Yee*, 147 B.R. 624, 625-26 (Bankr. D. Mass. 1992) (same); and *In re Bates*, 176 B.R. 104, 109 (Bankr. D. Me. 1994) (in applying similar state statute, finding that IRAs may be exempt under Section 522(d)(10)(E)). In the Fourth Circuit, see, for example, *In re Outen*, 220 B.R. 26, 27-31 (Bankr. D.S.C. 1998) (en banc bankruptcy court) (IRAs may be exempt under a state statute "nearly identical" to Section 522(d)(10)(E)). In the Seventh Circuit, see, for example, *American Honda Fin. Corp.* v. *Cilek (In re Cilek)*, 115 B.R. 974, 987-89 (Bankr. W.D. Wis. 1990) (IRAs may be exempt under Section 522(d)(10)(E)). In the Tenth Circuit, see, for example, *In re Garrison*, 108 B.R. 760, 768 (Bankr. N.D. Okla. 1989) (explaining that state exemption law which did not cover IRAs could be amended to include IRAs "by enacting a statute somewhat like present 11 U.S.C. § 522(d)(10)(E)"). In the Eleventh Circuit, see, for example, *In re Suarez*, 127 B.R. 73, 81 (Bankr. S.D. Fla. 1991) (IRAs may be exempt under Section 522(d)(10)(E) and related state statutes); and *Dionne* v. *Harless (In re Harless)*, 187 B.R. 719, 728 (Bankr. N.D. Ala. 1995) (noting that Section 522(d)(10)(E) "exempts payments under IRAs from the bankruptcy process"). In the D.C. Circuit, see *In re Burkette*, 279 B.R. 388, 393 (Bankr. D.D.C. 2002) (finding that IRAs may be exempt under Section 522(d)(10)(E), without directly addressing whether the tax penalty for early withdrawal of IRAs satisfies the "on account of * * * age" provision).

II. IRAS ARE "SIMILAR PLAN[S] OR CONTRACT[S]" UNDER SECTION 522(D)(10)(E).

The conclusion that IRAs are exempt under Section 522(d)(10)(E) follows from the text, purposes, and history of the statute.

A. Only Petitioners' Position Can Be Reconciled With The Text Of The Bankruptcy Code.

1. The first indication that Section 522(d)(10)(E) exempts IRAs from the bankruptcy estate is that the statute specifically incorporates the provision of the Internal Revenue Code governing IRAs. Sections 522(d)(10)(E)(i)-(iii) specify three conditions that, if each is met, will cause an otherwise valid exemption to be lost. Among these is the condition – set forth in Section 522(d)(10)(E)(iii), which uses the same "plan or contract" language as in subsection (E) – that a plan "does not qualify under section 401(a), 403(a), 403(b), *or 408* of the Internal Revenue Code of 1986" (emphasis added). Section 408 sets out the requirements for favorable tax treatment for IRAs.[6]

[6] Section 401(a) sets out the requirements for favorable tax treatment for pension, profit-sharing, and stock bonus plans. Section 403 sets out the requirements for favorable tax treatment for annuities.

The logical corollary of the exclusion from Section 522(d)(10)(E) of plans that "[do] not qualify under section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code" is the *inclusion* of plans – including IRAs under Section 408 – that do so qualify. When Section 522(d)(10)(E)(iii) groups together pension, profit-sharing, and stock bonus plans, annuities, and IRAs, by referring to the Internal Revenue Code sections that define these forms of retirement savings, the message is clear: each of these forms of retirement savings is eligible for exemption from a debtor's estate. As the Ninth Circuit observed, "[t]here could be no reason for legislatures to exclude *non-qualifying* IRAs from the exemption, as the exception does, unless they intended that *qualifying* IRAs could be exempt. Indeed, there could be no reason even to mention Section 408, the IRA section, unless 'similar plan or contract' included them." *Farrar* v. *McKown*, 203 F.3d 1188, 1190 (CA9 2000) (emphasis added); accord *Dettmann* v. *Brucher*, 243 F.3d 242, 243 (CA6 2001); *Dubroff* v. *First Nat'l Bank of Glens Falls*, 119 F.3d 75, 77-78 (CA2 1997); *Carmichael* v. *Osherow*, 100 F.3d 375, 378 (CA5 1996).

2. The text of Section 522(d)(10) also elucidates a set of criteria for determining whether a particular device is sufficiently "similar" to the specific devices listed within Section 522(d)(10)(E) to qualify for exemption from the bankruptcy estate, or whether the device is instead more analogous to household goods that may be sold to satisfy creditors. The requirement of "similarity" essentially embodies the *ejusdem generis* and *noscitur a sociis* canons – *viz.*, that a word is known by the company it keeps. See, *e.g.*, *Norfolk & W. R. Co.* v. *Train Dispatchers*, 499 U.S. 117, 129 (1991). IRAs share all the relevant characteristics of the plans and contracts specifically identified by Section 522(d)(10)(E), and thus IRAs equally qualify for exemption under the statute.

Section 522(d)(10)(E) sets forth criteria for withdrawing funds. Under federal law, funds may be withdrawn from an IRA "for medical care" – that is, on account of illness, 26 U.S.C. 72(t)(2)(B); if the account holder is "disabled," *id.*

§ 72(t)(2)(A)(iii); "on or after [the account holder's] death," *id.* § 72(t)(2)(A)(ii); or "on or after the date on which the IRA holder "attains age 59½," *id.* § 72(t)(2)(A)(i). These are the same four events that entitle individuals to favorable Internal Revenue Code treatment of payments under stock bonus, pension, profit-sharing, and annuity plans. See 26 U.S.C. 72; *id.* § 401; *id.* § 403. These are also four of the five qualifications (excluding "length of service") of exempt plans listed in Section 522(d)(10)(E).

A second measure of similarity is the tax status of IRA contributions. An IRA is a tax-preferred plan, which means that contributions to IRAs are tax deductible, just like contributions to a 401(k) or other qualified retirement savings plan. Thus, the funds contributed to an IRA from present income are not taxed until they are withdrawn at a future point in time, generally during retirement.

A third measure of similarity is the restriction on contributions imposed by federal law. Like the other "defined-contribution" plans listed in Section 522(d)(10)(E) – such as stock bonus plans, profit-sharing plans, and a significant and rising number of pension plans – an IRA holder contributes a specific amount of stock or money to his account. See Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1546-47 (1997); see also David A. Pratt, *Nor Rhyme Nor Reason: Simplifying Defined Contribution Plans*, 49 BUFF. L. REV. 741, 745 (2001) ("All defined contribution plans have the same basic purpose – the accumulation of funds for retirement * * *."). And as with other qualified plans, there are annual limits on the amount of income that can be contributed to an IRA. See Internal Revenue Serv., Traditional IRAs, *at* http://www.irs.gov/publications/p590/ch01.html#d0e1417 (IRA contribution limits); Internal Revenue Serv., Tax Topic 424 – 401(k) Plans, *at* http://www.irs.gov/taxtopics/tc424.html (limits on deferred compensation plans such as 401(k) plans).

B. Only Petitioners' Construction Can Be Reconciled With Congress's Purpose In Enacting Section 522(d)(10)(E).

1. The various plans that Congress specifically identified in Section 522(d)(10)(E) all serve a common purpose: they provide replacement income during retirement. Congress clearly understood that pension benefits typically supply the equivalent of future earnings for older persons. The legislative history explains: "Paragraph (10) exempts certain benefits that are *akin to future earnings of the debtor*. These include * * * benefits under a certain stock bonus, pension, profitsharing, annuity or similar plan." H.R. Rep. No. 95-595, at 361-62 (1977) (emphasis added). The aim of Section 522(d)(10)(E) is thus to allow exemption for plans "established for the primary purpose of providing benefits upon retirement." *Transmitting a Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-137, at 171-72 (1973).

Not surprisingly, Congress sought to protect older debtors' future earnings as generously as it protected a younger debtor's ability to earn wages free from the burdens of oppressive indebtedness. Congress's exemption of pensions from bankruptcy estates accordingly acknowledges the reality that benefits often take years to accumulate and that older debtors are unlikely to have the opportunity to re-accumulate the benefits essential to support them through old age.

There is no dispute that, had petitioners not been terminated from their positions with Northrop Grumman and rolled their pension assets into IRAs, those assets would have been exempt from the bankruptcy estate to the extent "reasonably necessary for [their] support." 11 U.S.C. 522(d)(10)(E). There is no reason to believe that Congress would have intended a merely nominal difference in the form of petitioners' retirement savings – a pension versus an IRA – to produce such a profound difference in the status of the asset for bankruptcy purposes. Instead, Congress would have intended persons in the position of petitioners – individuals who lost their jobs and thus are less likely to have employment income with which to sustain themselves in the future – to have at least equivalent protections under the Bankruptcy Code.

At bottom, the Eighth Circuit failed to appreciate that IRAs perform the identical role of providing replacement income in retirement. Indeed, IRAs are such a common form of retirement savings in this country that, if they do not constitute a "similar plan or contract" under Section 522(d)(10)(E), that phrase in the statute has little or no meaning.

Indeed, changes in the U.S. economy have made IRAs an increasingly important form of retirement savings. Until the late 1970s, long-term employer-employee relationships predominated, see Stephen F. Befort, *Labor and Employment Law at the Millenium: A Historical Review and Critical Assessment*, 43 B.C. L. REV. 351, 366 (2002), and "the dominant pension form was still the defined benefit pension plan, sponsored and financed by the employer," Patricia E. Dilley, *Hidden in Plain View: The Pension Shield Against Creditors*, 74 IND. L.J. 355, 397 (1999). Today, by contrast, mobility is the norm. See John R. Keville, Note, *Retire at Your Own Risk: ERISA's Return on Investment?*, 68 ST. JOHN'S L. REV. 527, 542 (1994) ("Estimates indicate that typical American workers born after World War II will have at least ten jobs over the course of their working lives.").

As a result of these changes, fewer individuals participate in traditional defined-benefit, employer-provided pension plans. See *id.* at 534, 542-43; Bill Leonard, *Number of Employers Offering Traditional Pension Plans Continues To Dwindle*, SOC'Y FOR HUM. RESOURCE MGMT. ONLINE, Apr. 30, 2004, *at* http://www.shrm.org/hrnews_published/archives/CMS_008323.asp. Many individuals work over their careers for a series of different employers. Still other workers are self-employed for significant periods of time. As a result, more than forty percent of U.S. households now have IRAs, see Investment Co. Inst., Fundamentals: Investment Company

Institute Research in Brief 1 (2003), *available at* http://www.ici.org/shareholders/ret/fm-v12n3.pdf, and by the end of 1999 IRA assets totaled $2.5 trillion, Paul J. Graney, Cong. Res. Serv., Individual Retirement Accounts: A Fact Sheet 2, *available at* http://www.boozman.house.gov/UploadedFiles/RETIRE%20-%20Individual%20Retirement%20Accounts%20A%20Fact%20Sheet.pdf.

IRAs specifically are an important form of tax-preferred retirement savings for millions of self-employed Americans who are unable to participate in many conventional pension plans and therefore largely rely on IRAs. To exclude IRAs from the protection provided by Section 522(d)(10(E) "would be to suggest that Congress intended to penalize self-employed individuals for their choice of the form in which their retirement assets are held. This result would be antithetical to Congress' solicitude for retirement benefits for self-employed individuals." *Carmichael* v. *Osherow (In re Carmichael)*, 100 F.3d 375, 378 (CA5 1996).

For still other individuals, IRAs represent the consolidation of a series of smaller retirement savings vehicles. Workers who change jobs often amass retirement funds in several different plans, leading to an "unruly collection of qualified plan accounts." Richard L. Kaplan, *Retirement Funding and the Curious Evolution of Individual Retirement Accounts*, 7 ELDER L.J. 283, 290 (2000). As they approach retirement, "it often makes sense to bring these accounts into a single IRA to simplify account administration, coordinate distribution planning, and take advantage of economies of scale, particularly with regard to account maintenance fees." *Id.* When they change employment, workers may face the choice between preserving their retirement assets by rolling their pension funds into an IRA, or taking a taxable lump-sum distribution. See Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, 627 n.82 (2000); see also Internal Revenue Serv., Publication 575, *at* http://www.irs.gov/publications/p575/ar02.html#d0e2462 (describing the tax implications of taking a lump-sum distribution). Thus, nearly half of all traditional IRAs – including petitioners' – consist at least in part of funds that have been "rolled over" from employer-sponsored retirement plans. See Investment Co. Inst., *supra,* at 9. To strip bankruptcy protection from an individual's retirement funds because they are held as IRAs would simply "create a trap for the unwary." *Carmichael*, 100 F.3d at 378. Indeed, to do so would be profoundly unjust, because third parties, rather than individual debtors, often dictate the precise form of a retirement plan.

2. The history of the legislation that created IRAs demonstrates that Congress intended the role of IRAs in providing for retirement savings to be indistinguishable from traditional employer-sponsored retirement plans. In 1974, when Congress enacted the comprehensive Employee Retirement Income Security Act (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended at 26 U.S.C. 410-411 and in scattered sections of Title 29), it created IRAs under Internal Revenue Code Section 408 as a new retirement savings vehicle intended to address two problems: First, many individuals were not covered under qualified employee pension plans because their employers did not offer them, but at the same time could not set up so-called Keogh (or H.R. 10) plans because they were not self-employed. See Self-Employed Individuals Tax Retirement Act of 1962, Pub. L. No. 87-792, 76 Stat. 809 (codified as amended in various sections of 26 U.S.C.); 120 CONG. REC. H8699 (1974) (statement of Rep. Erlenborn) (describing IRAs as "finally provid[ing] equity for those who are not self employed * * * and yet are not employed by an employer who furnishes them a company plan").

The creation of the IRA solved this problem by "provid[ing] deductions for a modest retirement savings set-aside for those who are not covered by any existing plans." S. Rep. No. 93-383 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4890; see President Gerald Ford, Remarks and Statements by the President of the United States Upon Signing the Employee Retirement Income Security Act of 1974 (Sept. 2, 1974) (stating that one of the "seven essential parts to this

legislation * * * * [is that it] will * * * allow the one-half of American employees not covered by private pension plans to enjoy equivalent tax advantages if they set up individual retirement accounts * * *."); 120 CONG. REC. H8714 (1974) (statement of Rep. Collier) ("Both the House and Senate versions contained so-called IRA's and I think that this is one of the most critical provisions in this legislation. It is designed to allow noncovered individuals to obtain some pension benefits when they retire.").

Second, IRAs were designed to permit workers who changed jobs to bring their retirement funds with them. Before ERISA, pension funds and funds from Keogh plans often could not be moved when a worker moved from one employer to another without losing their tax-exempt status. See 2 SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND PUB. WELFARE, 93D CONG., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 1627 (Comm. Print 1976). By allowing employees to "roll over" funds without penalty from other tax-deferred savings plans into a single account without penalty, IRAs were seen as an important simplifying and consolidating tool for America's increasingly mobile workforce. As the Senate report accompanying ERISA explained:

> Ours is a highly mobile economy and employees frequently transfer from one job to another, particularly in their early years. As a result, employees frequently acquire vested rights to pensions under a number of different retirement plans established by previous employers. In view of the fact that some of the retirement rights will generally have been acquired many years before the employee retires, he may forget to claim all his retirement benefits. In addition, in such cases, the plans involved may not be able to locate the employee to pay him his retirement benefit. * * * [P]ermitted under certain circumstances are transfers from a qualified pension, etc., plan to an individual retirement account, a new retirement savings provision added by the bill which is explained below.

S. Rep. No. 93-383 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4915-16; see also President Gerald Ford, Remarks and Statements by the President of the United States Upon Signing the Employee Retirement Income Security Act of 1974 (Sept. 2, 1974) (describing as the seventh "essential part[]" of ERISA the fact that "the act will establish a limited form of portability of pension benefits by allowing workers to transfer some of their pension benefits to other plans or to their individual retirement accounts"); *Employee Retirement Income Security Act of 1974: Conference Report*, 120 CONG. REC. S15,746 (1974) (statement of Sen. Javits) ("The conference agreement expands the tax-free rollovers to permit portability between qualified plans with the individual retirement account serving as the substitute for the central portability fund of the Senate bill.").

3. Holding that IRAs and the specifically listed plans in Section 522(d)(10)(E) are exempt from the bankruptcy estate when "reasonably necessary for the support of the debtor" serves a central purpose of the bankruptcy laws: enabling debtors "to retain exempt property so that they will be able to enjoy a 'fresh start' after bankruptcy." *United States* v. *Security Indus. Bank*, 459 U.S. 70, 72 n.1 (1982). By serving as a replacement for income during retirement, IRAs provide a guarantee of financial support to retirees no longer able to earn a wage – thereby keeping the debtor from becoming "destitute and a public charge." H.R. Rep. No. 95-595, at 126 (1977).

Exemption laws, which place certain assets of the debtor beyond the reach of creditors, are an integral component of the "fresh start" principle, because they allow the debtor to retain what is necessary to get back on his feet and thus prevent the debtor from slipping back into bankruptcy. See S. Rep. No. 95-989 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5862; see also *Security Indus. Bank*, 459 U.S. at 72 n.1.

As the preeminent bankruptcy authority explains, "For most individual debtors, regardless of the chapter under which the debtor filed the petition, no section of the Bankruptcy Code is more important than section 522, which governs the debtor's rights in relation to exempt property and is crucial to the 'fresh start' envisioned by drafters of the code." 14 COLLIER ON BANKRUPTCY, at Intro.02 (15th ed. 2004).

Section 522(d)(10), in particular, embodies the "fresh start" principle. While younger debtors may have many years of gainful employment ahead of them, pension benefits and IRAs may be the only source of future income for many older persons who have lost their jobs and have little prospect of adequate re-employment because of market conditions, age, or disability. Older debtors forced into bankruptcy by unemployment may lack the skills necessary to re-enter the workforce – or, for those previously supported by a recently deceased spouse, to enter for the first time – and they often struggle to find jobs, particularly when the economy is weak. Many are hindered in their employment prospects by the same ill health, work-related disabilities, or need to stay home to care for a family member that led to bankruptcy in the first place. As a result, debtors who are either already retired or nearing retirement may be significantly dependent on the funds in their IRAs.

C. Construing Section 522(d)(10)(E) To Cover IRAs Is Consistent With The Longstanding Congressional Practice Of Exempting Pensions And Other Forms Of Future Support.

The Bankruptcy Reform Act of 1978, like all of its predecessors, explicitly exempts certain property from a debtor's estate to give the debtor a "fresh start" and a means of support. Section 522(d)(10) is thus the heir to a long line of statutory exemptions – including specifically exemptions for pension assets – that are premised on Congress's conclusion that it is essential to allow the debtor to start anew.

Each of the five bankruptcy Acts enacted in the last two centuries has recognized the debtor's right to exempt certain property from liquidation or the reach of creditors. The very first bankruptcy Act not only allowed the debtor to exempt certain personal apparel and bedding, but it also permitted him to receive a portion of the proceeds from the liquidation of his non-exempt assets and, further, "such allowance out of the bankrupt's estate * * * as [the supervising officials may deem appropriate] for the necessary support of the said bankrupt and his family." Act of Apr. 4, 1800, ch. 19, §§ 5, 34, 53, 2 Stat. 19 (repealed 1803). Similarly, the Act of 1841 provided an exemption for necessary apparel, household and kitchen furniture, and other articles of personal property, not to exceed $300 in value. Act of Aug. 19, 1841, ch. 9, § 3, 5 Stat. 440 (repealed 1843); see Francis Hilliard, *A Treatise on the Law of Bankruptcy & Insolvency* § 74, at 164 (2d ed. 1867) (discussing Act of 1841); *Williams* v. *Miller*, 16 Conn. 144 (1844) (holding that property exempt through bankruptcy was not subject to levy and that the debtor could recover for wrongful execution).

Expanding the concept considerably, the Act of 1867 allowed the debtor an exemption for all of the items listed in the Act of 1841 (with a new aggregate limit of $500), together with (1) the debtor's clothing; (2) for soldiers, the debtor's uniform, arms, and equipment; (3) property exempt from execution under federal law; and (4) subject to certain restrictions, property that the debtor could claim as exempt from levy under otherwise applicable state law. Act of Mar. 2, 1867, ch. 176, § 14, 14 Stat. 517 (repealed 1878); see *In re Beckerford*, 3 F. Cas. 26, 27 (C.C.E.D. Mo. 1870) (No. 1209) (holding that the proceeds of exempt property were also exempt and explaining that "the state, for its own purposes, and the well-being of the individual and family, has secured what are deemed necessaries, against the claims of creditors, and directed the latter to look to the other property and integrity of his debtor for security").

Subsequently, the Act of 1898 did not itself designate any specific items of property as subject to a right of exemption, but nevertheless followed the Act of 1867 in allowing the debtor to exempt property sheltered from execution under otherwise applicable state or federal law. Act of July 1, 1898, ch. 541, § 6, 30 Stat. 544, 11 U.S.C. 24, *amended by* Chandler Act, ch. 575, 52 Stat. 840 (1938) (repealed 1979). Specifically, Section 6 provided: "This Act shall not affect the allowance to bankrupts of the exemptions which are prescribed by the laws of the United States or by the State laws in force at the time of the filing of the [debtor's bankruptcy] petition." *Id.* § 6, 52 Stat. 847; see *White* v. *Stump*, 266 U.S. 310, 312-14 (1924) (discussing operation of Section 6); *Hanover Nat'l Bank* v. *Moyses*, 186 U.S. 181, 190 (1902) (upholding constitutionality of provision); 1A COLLIER ON BANKRUPTCY ¶ 6.01, at 793-96 (14th ed. 1988) (discussing section).

While the Act of 1898 was in effect, debtors either were or became entitled to exempt a variety of pensions under numerous state and federal laws. For example, as a matter of federal law, veterans' pensions were designated as exempt from the reach of creditors. See 38 U.S.C. 54, *renumbered and amended as* 38 U.S.C. 3101 (current version at 38 U.S.C. 5301); see also 45 U.S.C. 231m (railroad retirement benefit similarly exempt). Pursuant to the express provisions of Section 6 of the Act, pensions exempt under federal law were likewise exempt in bankruptcy. See, *e.g.*, *In re Bean*, 100 F. 262 (D. Vt. 1900) (pension and proceeds thereof held exempt). Similarly, myriad state laws have long exempted pensions from the reach of creditors. See, *e.g.*, *Dargan* v. *Williams*, 66 Neb. 1, 91 N.W. 862 (1902) (pension and proceeds thereof exempt under state law); *Yates County Nat'l Bank* v. *Carpenter*, 119 N.Y. 550, 23 N.E. 1108 (1890) (same); *Diamond* v. *Palmer*, 79 Iowa 578, 44 N.W. 819 (1890) (discussing pension exemption under state law).

The expansion of a debtor's right of exemption to include pensions under the Act of 1898 complemented the debtor's ability to shield his future earnings from the reach of pre-

petition creditors. Reflecting centuries-old practice, the debtor's bankruptcy filing and discharge under the Act prevented pre-petition creditors from recovering their claims against the debtor's future assets by blocking execution during the bankruptcy proceeding and discharging the debtor from personal liability. See Act of July 1, 1898, ch. 541, §§ 11, 14, 17, 30 Stat. 544 (repealed 1979); G. Eric Brunstad, Jr., *Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law*, 55 BUS. LAW. 499, 513-22, 571-76 (2000) (discussing the historical evolution of debtor relief provisions in U.S. bankruptcy law and the effects of insolvency on debtors); 1A COLLIER ON BANKRUPTCY ¶ 11.02, at 1141-48; ¶ 14.02, at 1261-65; ¶ 17.02, at 1581 (14th ed. 1988) (discussing Sections 11, 14 & 17 of the Act of 1898); see also Hilliard, *supra*, § 73, at 161 (commenting in 1867 on established bankruptcy practice: "[h]ence it has been held that all the acquisitions of a bankrupt, made after the filing of his petition in bankruptcy, are exempt from liability to pay debts previously contracted" (citation omitted)). As this Court remarked in 1918:

> The federal system of bankruptcy is designed not only to distribute the property of the debtor, not by law exempted, fairly and equitably among his creditors, but as a main purpose of the act, intends to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors.

Stellwagen v. *Clum*, 245 U.S. 605, 617 (1918). The Court added a few years later: "This purpose of the act has been again and again emphasized * * * in that it gives the honest but unfortunate debtor * * * a new opportunity in life * * *. The various provisions of the Bankruptcy Act were adopted in light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act." *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244-45 (1934).

In crafting the provisions of the Bankruptcy Code to replace the Act of 1898, Congress expressly excluded from the bankruptcy estate the debtor's future earnings from personal services following the filing of the debtor's case. See 11 U.S.C. 541(a)(6). Congress likewise provided that, following the debtor's discharge, the debtor's property (including future earnings) would generally not be subject to execution to satisfy the debtor's pre-petition obligations. See 11 U.S.C. 524(a)(2)-(3) (providing that, with the exception of certain enumerated non-dischargeable debts such as alimony and child support, the discharge operates as an injunction against efforts to collect pre-petition debts from the debtor or the debtor's property); see also 11 U.S.C. 523 (prescribing exceptions to discharge).

As the foregoing reveals, the history of the debtor's exemptions and discharge is one of an expanding concept focused in tandem on the preservation of the debtor's ability to maintain at least some minimal stream of future earnings, whether through wages or income akin to wages. That history of expansion continued with the Bankruptcy Reform Act of 1978, which enacted the modern bankruptcy code. The 1978 Act broadened the available exemptions to encompass plans "established for the primary purpose of providing benefits upon retirement," H.R. Doc. 93-137, at 171-72 (1973), a description that – as the Act's history reflects – unquestionably applies to IRAs.

In 1970, Congress created the Commission on the Bankruptcy Laws of the United States "to study and recommend changes in bankruptcy laws." See H.R. Rep. No. 95-595, at 2-3 (1977). In July 1973 the Commission filed with Congress its final report, which included both a set of recommendations and a draft bill to implement those recommendations. *Id.* The Commission's proposed bill included a provision defining the exempt property of the debtor. That bill proposed exempting retirement assets as follows:

> Before or after retirement, such rights as the debtor may have under a profit sharing, pension, stock bonus, annuity, or similar plan which is established for the primary purpose of providing benefits upon retirement by reason of age, health, or length of service, and which is either (A) qualified under section 401(a) of the Internal Revenue Code, or any successor thereto, or (B) established by federal or state statute, to the extent in either case the debtor's interest therein is reasonably necessary for the support of the debtor and his dependents.

Transmitting a Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. 93-137, at 171-72 (1973).[7] Early drafts of the Bankruptcy Reform Act, however, explicitly mentioned only pension plans qualifying under 26 U.S.C. 401(a). See *Bankruptcy Reform Act: Hearing on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery, of the Senate Comm. on the Judiciary*, 94th Cong. 8 (1975) (prepared statement of the Commission on Bankruptcy Laws of the United States). This omission of other forms of retirement plans was repeatedly criticized in committee hearings as overly restrictive. See, *e.g.*, *Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery, of the Senate Comm. on the Judiciary*, 94th Cong. 817 (1975) (statement of William T. Plumb, Jr., consultant to the Commission on the Bankruptcy Laws); *id.* at 630-31 (statement of the American Life Insurance Association). Retirement plans under Section 403 should also qualify for exemption, critics argued, as well as plans under Sections 408 and 409, which had been enacted after the bankruptcy bills were introduced in

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[7] The Commission's proposed bill was introduced in the 93rd Congress as S. 4026 and H.R. 10792, and again in the 94th Congress as S. 236 and H.R. 32. A companion bill drafted by representatives of the National Conference of Bankruptcy Judges was introduced as S. 235 and H.R. 31, and both sets of bills were sent to committee for hearings. See H.R. Rep. No. 95-595, at 2-3 (1977).

the previous session. "[I]f individually-provided retirement funds under 'H.R. 10' [section 401(c), or "Keogh" plans] are to be exempted, the exemption should surely extend to the more modest retirement arrangements dealt with in sections 408 and 409 of the code * * *." *Id.* at 817 (statement of William T. Plumb, Jr.). While debating how broadly to write the exemption, in 1975 (shortly after IRAs came into existence) the Senate subcommittee that worked on the bill asked a witness from the American Life Insurance Association (ALIA), "Why do you believe that it is more equitable to include in the proposed exemptions all pension plans qualifying under section 401, 403, 408 or 409 of the Internal Revenue Code rather than just section 401(a)?" In response, the witness testified: "Each of the tax qualified retirement plans has been recognized by Congress as a means of encouraging retirement planning. ALIA does not believe the availability of an exemption in respect of retirement income should depend on the choice or chance of the retirement benefit program." *Id.* at 679 (statement of John J. Creedon, ALIA).[8] Congress responded by passing a version of the final bill that added plans under Sections 403, 408, and 409 to the list of retirement plans named in Section 522(d)(10)(E)(iii). See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

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[8] This history confirms that the retirement plans listed in Section 522(d)(10)(E)(iii) were understood to be the "stock bonus, pension, profitsharing, annuity, or similar plan[s] or contract[s]" exempted by Section 522(d)(10)(E). The subcommittee's question regarding the equity of "includ[ing] in the proposed exemptions *all pension plans qualifying under section 401, 403, 408 or 409* of the Internal Revenue Code rather than just section 401(a)" evinces an understanding that the plans listed in Section 522(d)(10)(E)(iii) all qualify for exemption. The witness's response, too, clearly shows that what was at stake was whether plans under Sections 403, 408, or 409 would qualify for exemption. By listing all of these plans in Section 522(d)(10)(E)(iii), Congress answered in the affirmative.

III. THERE IS NO MERIT TO THE THIRD CIRCUIT'S ALTERNATIVE RULE THAT IRAS ARE EXEMPT ONLY IF THE DEBTOR HAS REACHED AGE 59½ BY THE TIME OF BANKRUPTCY.

In *Clark* v. *O'Neill (In re Clark)*, 711 F.2d 21 (1983), the Third Circuit held, contrary to the approach taken by every other court to have addressed the question, that until a debtor has reached the age of 59½ and is therefore permitted to withdraw funds without any tax penalty, he has no right to exempt the corpus of his IRA from the bankruptcy estate. (Presumably, a debtor who has reached that age can exempt both present payments and the corpus that will generate future payments necessary for his support.) According to the Third Circuit, to permit exemption for a retirement fund whose owner has not yet reached age 59½ "demonstrates a concern for the debtor's long-term security which is absent from [section 522(d)(10)(E)]." *Clark*, 711 F.2d at 23. Therefore, the court concluded, while exemption for "present payments" is permitted, exemption for "future payments" is prohibited. *Id.*

Respondent did not raise this argument below, and as noted earlier, the Eighth Circuit held precisely the opposite – that a debtor's access to his IRA is *too unlimited* to qualify for exemption.

The language and the purpose of Section 522(d)(10) establish that both present payments and the undistributed corpus should be eligible for exemption when the remaining requirements of the statute are satisfied. Specifically, the corpus should be exempt to the extent that the funds are "reasonably necessary for the support of the debtor and any dependent of the debtor."

The Third Circuit's arbitrary distinction between "present" and "future" payments should be rejected for four reasons. First, Section 522(d)(10)(E) does not simply provide for the exemption of current payments under a qualifying retirement savings device. Rather, it protects the "right to receive" such payments, a phrase that inherently contemplates

both present *and* future payment rights. See William T. Plumb, Jr., *The Recommendations of the Commission on the Bankruptcy Laws—Exempt and Immune Property*, 61 VA. L. REV. 1, 58 (1975) ("Since this proposed exemption refers to the debtor's 'rights * * * under a * * * plan,' rather than to 'payments,' 'identifiable proceeds,' or 'benefits' (as other proposed exemptions do), it apparently will not exempt any pension payments or lump sum distributions already in the hands of the debtor."); cf. *Till* v. *SCS Credit Corp.*, 124 S. Ct. 1951, 1976 (2004) (Scalia, J., dissenting) (describing, in the context of a Chapter 13 wage earner adjustment plan, the funds that a creditor will be paid in the future as "the right to receive payments"); *Legg* v. *St. John*, 296 U.S. 489, 495-96 (1936) (stating, under the 1898 Act, that the debtor's "right to receive disability benefits in the future" is "in essence an annuity" and thus "[l]ike other property, it passe[s] to the trustee, unless exempted"). Particularly because the precise timing of qualifying payments from several of the savings devices listed in Section 522(d)(10) is discretionary, it would be perverse to draw a categorical distinction on the basis of when payments are made.

By exempting the right to receive payments, as opposed to the payments themselves, the statute seeks to exempt from the estate a substitute for future earnings – income that has been earned and saved, but not yet paid. See H.R. Rep. No. 95-595, at 362 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6318 ("Paragraph (10) exempts certain benefits that are akin to future earnings of the debtor."). Just like a debtor aged 59½, a fifty-nine-year-old debtor has a right to receive payments from his IRA, even if he must wait six months to exercise it without penalty. Had Congress intended to exempt only current payments the task would have been easy enough to accomplish – by inserting the word "present," "current," or "existing" before "right." Yet the text of Section 522(d)(10)(E) demonstrates no such intention, distinguishing between debtors based *only* on their needs and without reference to age.

To be sure, Section 522(d)(10)(E) permits exemption only to the extent that the payments a debtor has the right to receive are necessary to his support. Thus, with respect to *either* present payments or the corpus from which future payments will be made, funds beyond that amount will become part of the bankruptcy estate, which the bankruptcy trustee will convert to cash and distribute to the creditors.[9]

With respect to IRAs – and indeed, with respect to *all* of the retirement savings devices covered by Section 522(d)(10)(E) – a debtor's age, physical condition, and other characteristics will affect the availability and extent of the exemption. Younger debtors, who can use current wages to support themselves and who have many years to accumulate a new retirement nest egg, may well be required to hand over their entire IRA to the trustee for distribution to their creditors. See, *e.g.*, *In re Kochell*, 732 F.2d 564, 566 (CA7 1984) (holding that a forty-four-year-old debtor's IRA was not exempt because "he could easily reestablish a retirement fund"); *In re Bowder*, 262 B.R. 919, 924 (Bankr. D. Minn. 2001) ("The Court finds that the Debtor has ample time and ability to prepare for retirement, including entirely re-funding the relatively modest IRA, and that the IRA is therefore not reasonably necessary to sustain his basic needs in retirement and not exempt."). By contrast, as noted, older debtors may lack the skills or opportunities to re-enter the workforce and accumulated further savings. Consequently, they may be eligible to keep the entire corpus. See, *e.g.*, *In re Burkette*, 279 B.R. 388, 394-95 (Bankr. D.D.C. 2002) ("The debtor's ad-

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[9] Thus, the bankruptcy laws are entirely capable of preventing debtors from using IRAs to improperly shield their assets. Moreover, in addition to limiting the amount that can be exempted to funds "necessary for the support of the debtor and any dependents," thereby making amounts beyond the level necessary for support ineligible for exemption, the general prohibition on fraudulent transfers, 11 U.S.C. 548, applies to funds deposited in IRAs as well.

vanced age is a significant factor bearing upon the court's decision."); *In re Webb*, 189 B.R. 144, 146 (Bankr. S.D. Ohio 1995) ("[I]t would take [the debtor] many years to replace the funds currently in her IRA were they turned over to the trustee in bankruptcy."); *In re Weaver*, 98 B.R. 497, 500 (Bankr. D. Neb. 1988) ("[C]ases interpreting the phrase 'reasonably necessary for the support of the debtor and any dependent of the debtor' have distinguished between younger and elderly debtors."); Plumb, *supra*, at 94 ("The period for which [a debtor's] needs must be anticipated and provided for * * * presumably is to extend at least for the remaining life expectancy of the debtor * * *.").

Second, the Third Circuit rested its decision on the legislative history of Section 522(d)(10)(E), which actually supports petitioners' construction of the statute. The Third Circuit relied principally on a quotation from the legislative history taken out of context. In reaching its anomalous result in *Clark* v. *O'Neill*, the Third Circuit seized on an isolated sentence from a House Committee Report: "The historical purpose of [] exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge." *Clark*, 711 F.2d at 23 (quoting H.R. Rep. No. 95-595, at 126 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6087). On the basis of this sentence alone, the Third Circuit leapt to conclude that Section 522(d)(10)(E) only exempts "present payments" – that is, payments received by those who have already reached the statutory age (59½) at which penalty-free withdrawals are permitted. *Id.* at 23; see also *Velis* v. *Kardanis*, 949 F.2d 78, 82 (CA3 1991) (noting that "as a present entitlement," debtor's IRA was "susceptible to possible exemption under § 522(d)(10)(E)").

In fact, the portion of the Report from which this quotation was taken describes the need to *increase* the exemptions available to debtors, rather than a desire to restrict them. The full paragraph reads as follows:

> In a straight bankruptcy liquidation case, the debtor surrenders all of his nonexempt assets for sale by the trustee. The trustee then distributes the proceeds among the debtor's creditors. Under current law, what property is exempt is determined under state law. However, some state exemption laws have not been revised in this century. Most are outmoded, designed for more rural times, and hopelessly inadequate to serve the needs of and provide a fresh start for modern urban debtors. The historical purpose of these exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge. The purpose has not changed, but neither have the level of exemptions in many States. Thus, the purpose has largely been defeated.

H.R. Rep. No. 95-595, at 126 (1977) (footnote omitted), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6087. The next few paragraphs note the "federal interest in seeing that a debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start," and they propose a liberal exemption scheme that permits debtors to choose between state and federal exemptions. *Id.* Thus, the portion of the Report quoted by the Third Circuit was intended to persuade legislators to make bankruptcy exemptions *more* generous, not less, and in no way evinces an intent to limit the availability of a debtor's exemptions.

Moreover, the Third Circuit ignored a much more relevant portion of the very same Report – one that contradicts its position. Describing the function of Section 522(d), the Report explains that "[p]aragraph (10) exempts certain benefits that are *akin to future earnings of the debtor*. These include * * * benefits under a certain stock bonus, pension, profitsharing, annuity or similar plan based on illness, disability, death, age, or length of service." H.R. Rep. No. 95-595, at 362 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6318 (empha-

sis added). To say that benefits falling under Section 522(d)(10) are "akin to future earnings of the debtor" is to recognize that the debtor will draw on these benefits at some later time, when they are needed for support. Just like stock bonuses, pensions, profitsharing plans, and annuities (as well as other kinds of benefits described in Section 522(d)(10), such as Social Security payments), IRAs provide a source of funds from which debtors may draw for support throughout retirement – when other sources of support, such as wages, are no longer available. This is precisely the type of future support to which Section 522(d)(10) is addressed.

Additional legislative history confirms that the exemption was intended to extend to all debtors when "reasonably necessary for * * * [their] support." The Commission on the Bankruptcy Laws of the United States, which created the report on which the Bankruptcy Reform Act of 1978 was based, see H.R. Rep. No. 95-595, at 2-3 (1977), produced the following recommendation with respect to exempt property:

> The following property * * * is also to be allowed as exempt under the proposed Act:
>
> * * *
>
> (6) *Before or after retirement*, such rights as the debtor may have under a profit sharing, pension, stock bonus, annuity, or similar plan which is established for the primary purpose of providing benefits upon retirement by reason of age, health, or length of service * * * to the extent * * * the debtor's interest therein is reasonably necessary for the support of the debtor and his dependents.

Transmitting a Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. 93-137, at 171-72 (1973) (emphasis added). The clear import of this passage is that retirement funds may be exempted whenever necessary for support, regardless whether the debtor has yet retired. Nothing in this passage – nor anything else in the legislative history of the Bankruptcy Reform Act – suggests that Congress intended to draw an arbitrary line between debtors above and below the age of 59½.

Third, the Third Circuit's rule would produce grossly inequitable – indeed, bizarre – results that Congress could not have intended: A debtor aged 59½ would be permitted to exempt as much of his IRA as is necessary for support, while a fifty-nine-year-old debtor could exempt nothing at all. But as both a practical and a theoretical matter, the value of an IRA to the two individuals is virtually identical. For both, an IRA offers a guarantee of support during retirement. For neither will it be possible to obtain that particular support from another source if the IRA is dissolved. To be sure, Congress could, if it so chooses, design a statute that treats the retirement funds of the former as categorically different from the funds of the latter, but this Court should not stretch the words of Section 522(d)(10)(E) to create a bright-line distinction when the statute declines to impose one. See FED. R. BANKR. P. 4003(c) (stating that under bankruptcy law, the trustee bears the burden of proving an exemption is unavailable to the debtor).

Petitioners' own situation demonstrates why the right to retain funds in a tax-qualified IRA should be approached on a case-by-case basis, as bankruptcy courts consistently approach a variety of questions regarding the assets that should be retained by debtors. As the court of appeals recognized, petitioners' IRAs were "established over time as part of a long-term retirement strategy" designed to support them in their old age. Pet. App. 5a. When they filed for bankruptcy, Richard Rousey was fifty-seven years old and petitioner Betty Jo Rousey was fifty-three. Their ability to replace those funds, a substantial part of which had been accumulated through their employer-sponsored pension plan and through the compounding of funds held for many years, is nonexistent. Nothing in the language, structure, or purpose of Section 522(d)(10)(E) suggests any reason why the fortuity that they filed for bankruptcy in 2001 rather than the year in

which they would be 59½ years old should determine the eligibility of their IRAs for exemption.

Fourth, even if the Third Circuit's erroneous assumption that Section 522(d)(10)(E) is unconcerned with a debtor's long-term security – an assumption based on a lone sentence taken out of context from the legislative history – were correct, petitioners should still be permitted to exempt their IRAs. For debtors, such as petitioners, who are on the verge of retirement, without sufficient time to re-create a retirement nest-egg from scratch, the retention of an IRA is very much a matter of present support. As one court observed, rebutting the Third Circuit's interpretation of Section 522(d)(10)(E), "characterizing asset accumulation for retirement as a matter of 'long term security[]' ignores the reality that, in most instances, individuals must save throughout their working years in order to have funds available for their retirement needs. Providing for 'long term security' is, in every sense, an individual's present (and continuing) concern." *In re Bates*, 176 B.R. 104, 109 (Bankr. D. Me. 1994) (citation omitted). To pretend that a debtor just shy of retirement has no present need to retain his retirement savings is to close one's eyes to the obvious. It may well force an older debtor into beggaring himself today in order to save even a pittance for tomorrow. The perverse result of the Third Circuit's rule is to encourage individuals to remain insolvent until age 59½ rather than entering into a prompt and economically efficient reorganization.

Taken to its logical conclusion, the Third Circuit's claim that Section 522(d)(10)(E) was intended only "to alleviate present rather than long-term need," *Clark*, 711 F.2d at 23, suggests that even when a debtor is over the age of 59½ – and thus eligible to receive the "present payments," as the Third Circuit claims is necessary to qualify for exemption – a bankruptcy court may not consider the debtor's long-term needs in determining whether to exempt his retirement funds. If retirement security were truly a "long-term need," as the Third Circuit maintains in *Clark*, then the ability to save for retirement should be irrelevant to the exemption decision whether or not the debtor is above the age of 59½. In other words, only the debtor's needs at the very moment of bankruptcy, without regard to his ability to amass a new retirement fund or support himself in the future, should determine the exemption's availability.

However, even courts purporting to apply the Third Circuit's distinction between present and future payments invariably look at the debtor's long-term financial outlook – including his prospects for amassing a new retirement nest-egg – when determining whether to exempt his retirement funds. See, *e.g.*, *In re Comp*, 134 B.R. 544, 554-55 (Bankr. M.D. Pa. 1991) (discussing the "age of the debtor" and his "ability to save for retirement" as considerations bearing on whether he qualified for exemption under Section 522(d)(10)(E)); *In re Velis*, 123 B.R. 497 (D.N.J. 1991) (same); see also *Reitmeyer* v. *Gralka (In re Gralka)*, 204 B.R. 184, 190 (Bankr. W.D. Pa. 1997) (if debtor were over age 59½, his "age" and "ability to save for retirement" would bear on the exemption decision). While inconsistent with *Clark*, this trend is unsurprising, because one would hardly expect courts to strip an older debtor of his retirement funds, leaving him with just enough to subsist for the time-being even if he is unable to work. Yet that is precisely what the Third Circuit's rule does to a debtor under the age of 59½, regardless of his age or proximity to retirement, his employment status, his health, or even his need.

Noting the absurdity of this result, a bankruptcy court in the Third Circuit refused to deny exemption to a fifty-six-year-old debtor's IRA merely because he was just shy of age 59½, instead drawing the line at age fifty-five.[10] *Pineo* v.

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[10] The court chose the age of 55 using the following reasoning:

> The Court borrows from I.R.C. § 72(t)(2)(A)(v) to arrive at age 55 as the precise age at which a debtor shall be deemed to have a sufficiently present right to receive payment from his or her IRA because (a) I.R.C.

Fulton (In re Fulton), 240 B.R. 854, 875-76 (Bankr. W.D. Pa. 1999). The court reasoned that "if the Court were to conclude otherwise and disallow *per se* an exemption of such funds to a bankruptcy debtor who has already reached age 55, then said debtor, given the urgency for retirement savings when one attains the age of 55, would be forced to allocate from his or her wages, *which wages would otherwise be utilized for his or her present needs*, an amount to at least partially replenish the IRA funds seized in bankruptcy." *Id.* at 875-76 (emphasis in original). The bankruptcy court correctly recognized that retirement support is not only a matter of concern to those over the age of 59½; but neither is it of concern only to those over fifty-five. Rather than draw an arbitrary line at age fifty-five (or any other age), this Court should permit exemption for the retirement funds of a debtor whenever "necessary for support." Common sense – and the plain language of Section 522(d)(10)(E) – dictate as much.

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§ 72(t)(2)(A)(v) operates to except from penalty taxation distributions from plans other than IRAs if a plan beneficiary has reached age 55, and (b) even though I.R.C. § 72(t)(2)(A)(v) does not so apply to except from penalty taxation distributions from an IRA, the Court detects neither reason nor necessity for discriminating, *within the bankruptcy context*, against beneficiaries of IRAs after said beneficiaries have reached, and have also abstained from withdrawing funds from said plans prior to reaching, age 55.

240 B.R. at 876 (emphasis in original).

CONCLUSION

For the foregoing reasons, the judgment of the U.S. Court of Appeals for the Eighth Circuit should be reversed.

Respectfully submitted,

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